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August 5, 2002

Via the Electronic Comments Filing System
Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW, Room TWB-204
Washington, DC 20554

Re: Notice of Proposed Rulemaking In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements
WC Docket No. 02-112

Dear Ms. Dortch:

Enclosed, please find Comments filed on behalf of the New Jersey Division of the Ratepayer Advocate in response to the above-captioned Federal Communications Commission's Notice of Proposed Rulemaking.

Very truly yours,

Seema M. Singh, Esq.
Acting Ratepayer Advocate and Director

By: /s/ Jose Rivera-Benitez__
Jose Rivera-Benitez, Esq.
Assistant Deputy Ratepayer Advocate

cc: Judith B. Herman (via electronic mail)
Jeanette Thornton (via electronic mail)

Before the
Federal Communications Commission
Washington, D.C.

Notice of Proposed Rulemaking:	)	
	)	**WC Docket No. 02-112**
In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements	)	

Comments of the New Jersey Division of the Ratepayer Advocate

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On the Comments

August 5, 2002

Table of Contents

I. Executive Summary.

The ultimate objective of the Federal Telecommunications Act of 1996 ("Act") was to deliver onto the marketplace full and open competition in both the local exchange and long distance markets. The Act contemplated that once the Federal Communications Commission ("FCC") determined that a Bell Operating Company ("BOC") had opened its local exchange market to competition in that jurisdiction, it would then be allowed to offer interstate long distance services. That grant of authority, however, would not be without restriction. Indeed, Section 272 of the Act prescribed parameters for fair dealing between the BOC affiliates so as to minimize the BOC's ability to exercise its acknowledged force in the market – despite the award of Section 271 authority – to the detriment of the market and the competitive local exchange carriers ("CLECs") seeking to compete. Those market parameters could sunset three years after the grant of Section 271 authority unless extended by the FCC. These comments, on behalf of the New Jersey Division of the Ratepayer Advocate ("Ratepayer Advocate"), respond to the FCC's notice for comments on what happens next, especially in view of the forthcoming first application of the sunset provision in New York.

In establishing the requirements of Section 272, the FCC foresaw the day when those same requirements would no longer be necessary to restrict the BOCs from discriminatory exercise of their overwhelming domination of local markets. The existence of substantial competition in the local exchange and exchange access market was identified early on as a valid indicator that the need for the requirements might be extinguished. It logically follows, therefore, that if there is not substantial competition, the necessity for the Section 272 requirements continues to exist, and the requirements must remain intact.

The Ratepayer Advocate submits that the structural separation requirements should not sunset automatically. Instead, in order for the FCC to determine whether the Section 272 requirements should sunset in a particular jurisdiction, it should undertake a multifactor analysis on an application filed by the BOC. That analysis would assess the market power of a BOC and if the BOC is shown to lack market power, the requirements of Section 272(b) could sunset. The Ratepayer Advocate foresees the publication of proposed rules for further comment that establish these criteria and procedures for examination of the BOC's application.

In the event that a BOC establishes it no longer has market power in a particular state, the Ratepayer Advocate submits that non-structural safeguards, including the provisions of Section 64.1903, should remain in order to monitor and help prevent backsliding behavior by the BOC. The FCC has previously had occasion to first establish, and subsequently, based on changed market conditions, lift structural requirements in another setting, substituting them with non-structural safeguards. The Ratepayer Advocate specifically proposes the implementation of quarterly reporting requirements coupled with penalties to ensure that once sunset occurs, the BOC will not discriminate in providing services to non-affiliated carriers, and will not engage in cost misallocation. Furthermore, the Ratepayer Advocate recommends an annual audit. As it stands, the biennial audit is insufficient to serve as a monitoring device because it does not adequately protect or discourage anti-competitive conduct as it is too infrequent, and only provides historic information.

In the event of sunset, the Ratepayer Advocate also recommends adoption of accounting safeguards similar to those adopted in the *Computer III* remand proceedings and the application of Section 64.1903 to a BOC.[1] The FCC could reduce non-structural safeguards as competitive market conditions improve or when there is evidence of the type of competitive local market the Act was designed to create. In this vein, it is necessary to note that the realization of the Act's fundamental thesis – fair competition – is a work in progress that calls for periodic review in order to assess its forward development.

[1] *Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards*, 6 FCC Rcd 7571 (1991) ("*BOC Safeguards Order*"), *recon. dismissed in part*, Order, CC Docket Nos. 90623, 92-256, 11 FCC Rcd 12513 (1996), *BOC Safeguards Order vacated in part and remanded, California v. FCC*, 39 F.3d 919 (9th Cir. 1994) ("*California III*"), *cert. denied*, 115 S.Ct. 1427 (1997) (hereinafter collectively referred to as "*Computer III*").

II. Section 272 Requirements Should not Sunset Automatically.

A. Section 272 Requirements Should be Extended by Rule Until the FCC Makes a Finding of Fact on an Application for Sunset Based on a Multifactor Analysis.

The FCC has asked whether the sunset provision will attach automatically or extend by rule or order. As a result of this Notice of Proposed Rulemaking ("NPRM"), the Ratepayer Advocate urges the FCC to adopt a general rule that automatically extends the separation requirements set forth in Section 272(b) until the BOC demonstrates that it lacks market power within a state where 271 authority has been granted.[2] The rule would require the separation requirements of Section 272(b) to remain in place in a state until after an order is issued by the FCC which concludes that the BOC lacks market power in that state in accordance with a multifactor analysis developed as part of a further notice of proposed rulemaking as discussed in Section III below. A proceeding to sunset the requirements of Section 272(b) could be commenced no earlier than three years after Section 271 authority was granted in a particular state. Such a proceeding would be initiated by a BOC's application to the FCC seeking a sunset of the Section 272(b) requirements where the BOC would have the burden of proof to show lack of market power.

The FCC has long recognized that the need for the anti-competitive requirements of Section 272 could end when there exists substantial competition in the local exchange and

[2] The NPRM makes it clear that the FCC interprets the sunset requirement of Section 272(f) as applying on a state-by-state basis. Although the FCC does not indicate the basis for this opinion, the Ratepayer Advocate submits this interpretation is consistent with the structure of the statute or in the alternative a permissible interpretation under the Chevron standard. See *Chevron U.S.A. v. NRDC, Inc.*, 467 U.S. 837, 843-45 (1984); *Bell Atlantic Telephone Companies v. FCC*, 131 F.3d 1044 (D.C. Cir. 1997).

exchange access service market.[3] As the FCC has granted Section 271 authority giving due regard to each jurisdiction's unique market conditions derived primarily from the state commission's fact-finding role in the Section 271 proceeding, then the lifting of the anti-competitive requirements of Section 272 must necessarily involve the same input from state commissions.

It is well recognized that competition differs from state to state. Therefore, the sunset of Section 272(b) should coincide with a finding that a state's local exchange and exchange access markets are substantially competitive based upon the BOC application that it no longer has market power in the particular jurisdiction under review. This is consistent with the plain language of Section 271 which requires that long distance authority be approved on a state-by-state basis and for the FCC to "consult with the State commission of any State that is the subject of the application in order to verify the compliance of the Bell operating company with the requirements of subsection (c)."[4] The FCC has also articulated that:

> "In requiring the FCC to consult with the states, Congress afforded the states an opportunity to present their views regarding the opening of the BOCs' local networks to competition. In order to fulfill this role as effectively as possible, state commissions must conduct proceedings to develop a comprehensive factual record concerning BOC compliance with the requirements of Section 271 and the status of local competition in advance of the filing of Section 271 applications. We believe that the state commissions' knowledge of local conditions and experience in resolving factual disputes affords them a unique ability to develop a comprehensive,

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3 *I/M/O Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, First Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-149, FCC 96-489, released December 24, 1996, at ¶ 13.

4 47 U.S.C. § 271(d)(2)(B).

> factual record regarding the opening of the BOCs' local networks to competition..."[5]

A similar rule would permit input from state commissions. States are in the best position to know the types of discriminatory actions that may occur within their borders, and the nature of the remedies needed to address these concerns.

Finally, states need time to develop their positions to inform the FCC of the status of competition. Continued application of Section 272(b) by rule would provide state commissions an opportunity to comment to the FCC on the particular nature of their concerns regarding the sunset and what safeguards should be in place to prevent anticompetitive behavior. The Ratepayer Advocate strongly recommends that individual states be given the opportunity to analyze and comment on whether the Section 272 requirements should sunset in their particular jurisdictions.

B. The Ratepayer Advocate Recommends that the FCC Engage in Further Notice of Proposed Rulemaking.

Due to the importance of the issues presented in this Notice, the Ratepayer Advocate urges the FCC to conduct a further notice of proposed rulemaking in order to establish the criteria of the multifactor analysis the FCC should impose and rely upon to determine lack of market power.

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[5] *Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan,* CC Docket No. 97-137, FCC 97-298, Memorandum Opinion and Order at ¶ 30 (hereinafter *Michigan Order*).

III. A Multi-factor Analysis is Required in Order to Determine the Nature of the Marketplace Three Years Post Entry.

In this section the Ratepayer Advocate provides its response to the FCC's request on the nature of the marketplace three years post-entry.[6] In order to reach factual conclusions on the nature of competition in any given jurisdiction three years post entry, the FCC is compelled to undertake a multi-factor analysis of local conditions, including examination of the effects of market power by the BOC. The fundamental purpose of Section 272 is to provide safeguards against anti-competitive conduct by the BOCs. The enactment of this provision necessarily recognizes that the BOCs could otherwise persist in the exercise of their market power absent appropriate safeguards. Therefore, the Ratepayer Advocate submits that as long as the BOCs continue to have market power in a particular jurisdiction, the requirements of Section 272(b) (collectively "separate affiliate requirements") should remain in place and should be automatically extended by rule. As discussed below, a BOC's continued market power compels the conclusion that the separate affiliate requirements remain in place in a particular state until a BOC can demonstrate that it lacks market power in that state and thus cannot manipulate market conditions.

A. The FCC Should Adopt a Multifactor Analysis to Assess Market Power.

The Ratepayer Advocate urges the FCC to adopt a multifactor analysis developed through a further notice of proposed rulemaking. The separate affiliate requirements would continue in each state until such time as a BOC can conclusively demonstrate that it lacks market

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6 *See* NPRM at 12.

power within a state where 271 authority has been granted.[7] The Ratepayer Advocate urges a separate rulemaking for adoption of factors to determine effective competition since the structure of this NPRM is more akin to a Notice of Inquiry and not rulemaking.[8]

The FCC should adopt a multifactor analysis to assess whether the BOC has market power. Market power necessarily includes the attendant ability to act to the detriment of competitors and otherwise preclude full and open competition. That multifactor analysis must show substantial competition, which in turn requires a BOC to demonstrate that it lacks market power by showing and/or providing:

(a) its market share in each wire center for all services other than services provided by its long distance affiliate;

(b) that the BOC's elasticity of demand and supply is high and not inelastic;

(c) a BOC's market share in its wire centers precludes the BOC from deterring or foreclosing competitive entry by anticompetitive practices;

(d) all complaints filed at the federal and state level, full and complete disclosure of the BOC's performance under the pertinent state performance plan, actions taken by or pending before the state commission, and Biennial Audit report(s);

(e) that the BOC's price for each service is free of subsidies and not below its fully distributed costs;

(f) the BOC's long distance affiliate income exceeds its expenses on a fully distributed cost basis (no subsidy is being provided from any source);

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7 As discussed above, the provisions of Section 272(b) should apply to each state and the separate affiliate requirements should remain in place for at least three years. A decision by the FCC to let the separate affiliate requirements sunset in one state should have no effect on the separate affiliate obligation in other states where the three year period has not expired.

8 The importance of the issues raised and what factors are required to show lack of market power are of such importance to warrant a separate proceeding with comment from all stakeholders. The current NPRM does not permit this because the FCC has proposed no factors for consideration but only raised general policy issues. As Commissioner Copps stated in his dissent *I/M/O Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities; Internet Over Cable Declaratory Order Proceeding; Appropriate Regulatory Treatment for Broadband Access to the Internet Over Cable Facilities* (FCC 02-77): "Last month I remarked that in our *Wireline Broadband* proceeding, we were out-driving the range of our headlights. Today I think we are out-flying the range of our most advanced radar."

(g) the BOC is experiencing sufficient and substantial competition within the state as measured by its market share which must be at or below 60% and the BOC must report the trends in market share erosion for each month since the grant of 271 authority;

(h) market data on the percent of customers for whom choice is available and the percent that have availed themselves of choice on a monthly basis since 271 authority was granted;

(i) ease of market entry and exit and the absence of market conditions that inhibit or impede entrants from expanding capacity and sales; and

(j) presence of other competitors who offer like or similar services at prices at or below a BOC's rates.

The FCC should require a BOC to file a petition with the supporting data and documentation in order to make a *prima facie* case that there is substantial competition in the state. The BOC's supporting data and documentation under the totality of the circumstances must show a lack of market power in that state. That petition would be subject to notice, comment and reply comment by all interested parties including the commission of the state where sunset was under consideration. The BOC would have the burden of proof to show lack of market power and the presence of substantial competition.

1. The FCC Routinely Considers Market Power in Determining the Dominant or Non-Dominant Status of Carriers.

The FCC has issued a long line of orders that deal with dominant carriers and issues of market power. In the leading FCC order on dominant carrier status the FCC declared that in the interstate domestic interexchange market taken as a whole, AT&T was no longer a dominant carrier even though its market share was 60%.[9] The BOCs argued that AT&T still had market power and that it was an obstacle to competition. The FCC discussed the need for and the

[9] *I/M/O Motion of AT&T Corp., to be Reclassified as a Non-Dominant Carrier*. FCC 95-427, 11 FCC Rcd. 3271 (rel. October 23, 1995). ("*Dominant/Non-Dominant Order*").

appropriateness of having reliable data on the demand and supply elasticity in order to determine market power and its relationship to market share. If demand and supply are inelastic, a low market share can result in market power and correspondingly, a high market share in a relevant geographic market with demand or supply being elastic will not constitute market power.

In its *Interconnection Order,*[10] the FCC addressed the fact that the BOCs continue to have monopoly control as a result of their control of bottleneck facilities and that the Act was intended to bring competition by opening up the local exchange market. The FCC stated that telephone regulation was in essence a monopoly service and that a new direction was ushered in by the Act.[11]

The FCC stressed that removal of statutory and regulatory barriers to entry is not sufficient to supplant the monopoly held by the incumbent local exchange carriers. The FCC stated in the *Interconnection Order*:

> 10. As pointed out in our Notice of Proposed Rulemaking in this docket, the removal of statutory and regulatory barriers to entry into the local exchange and exchange access markets, while a necessary precondition to competition, is not sufficient to **ensure**

[10] See *I/M/O Implementation of the Local Competition Provisions in the Telecommunications Act of 1995; Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98 and 95-185, FCC 96-235, First Report and Order, 11 FCC Rcd 15499 (*Interconnection Order*) (rel. August 8, 1996).

[11] The FCC stated at 1:

> The Telecommunications Act of 1996 fundamentally changes telecommunications regulation. In the old regulatory regime government encouraged monopolies. In the new regulatory regime, we and the states remove the outdated barriers that protect monopolies from competition and affirmatively promote efficient competition using tools forged by Congress. Historically, regulation of this industry has been premised on the belief that service could be provided at the lowest cost to the maximum number of consumers through a regulated monopoly network. State and federal regulators devoted their efforts over many decades to regulating the prices and practices of these monopolies and protecting them against competitive entry. The 1996 Act adopts precisely the opposite approach. Rather than shielding telephone companies from competition, the 1996 Act requires telephone companies to open their markets to competition.

> **that competition will supplant monopolies**. A incumbent LEC's existing infrastructure enables it to serve new customers at a much lower incremental cost than a facilities-based entrant that must install its own switches, trunking and loops to serve its customers. Furthermore, absent interconnection between the incumbent LEC and the entrant, the customer of the entrant would be unable to complete calls to subscribers served by the incumbent LEC's network. Because an incumbent LEC currently serves virtually all subscribers in its local servicing area, an incumbent LEC has little economic incentive to assist new entrants in their efforts to secure a greater share of that market. An incumbent LEC also has the ability to act on its incentive to discourage entry and robust competition by not interconnecting its network with the new entrant's network or by insisting on supracompetitive prices or other unreasonable conditions for terminating calls from the entrant's customers to the incumbent LEC's subscribers.
> (Footnotes omitted and emphasis added)
>
> 11. Congress addressed these problems in the 1996 Act by mandating that the most significant economic impediments to efficient entry **into the monopolized local market** must be removed. **The incumbent LECs have economies of density, connectivity, and scale; traditionally, these have been viewed as creating a natural monopoly.**[12]
> (Footnotes omitted and emphasis added)

In 1997, the FCC reiterated these concerns and concluded that Southwestern Bell Telephone Company ("SWBT"), a BOC, has a monopoly in the local exchange market.[13] The FCC found that SWBT's monopoly was sufficient to frustrate entry and to derail competition. As a dominant carrier, SWBT had the ability to restrain and impede entry in order to retain their position in the market. The FCC found:

> Based upon this record, we are concerned that Transmittal 2633 may permit SWBT unreasonably to deter or foreclose competitive entry into the markets in which it has a monopoly. As formulated,

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12 See *Interconnection Order* at ¶ 10 and 11.

13 See *I/M/O Southwestern Bell Telephone Company, Tariff F.C.C. No. 73*, FCC 97-394, 12 FCC Rcd. 19311 at 42 (rel. November 14, 1997) (*SWBT Order*). In the proceeding, the FCC found that a tariff filing by SWBT that sought permission to revise its tariffs was unlawful. SWBT asked for permission to charge below its tariff rates for access service in response to request for proposals received from customers. The FCC rejected the filing.

> Transmittal 2633 allows SWBT a virtually unlimited opportunity to preempt new market entrants in its territory by reducing rates to individual customers to which it believes new entrants may make offers, without making those rates available to similarly situated customers elsewhere. The threat of such market foreclosure is inconsistent with our ultimate goal -- competition for the provision of access service and the deregulation of incumbent LEC access services. Thus, absent a more persuasive showing of competition than exists in the record here, we find that the potential for SWBT to use this targeted tariff to deter market entry into its local exchange and exchange access market or to drive recent entrants from the market warrants a finding that offerings under Transmittal 2633 would be unreasonably discriminatory, the competitive necessity doctrine should not be available and, therefore, that Transmittal 2633 is unlawful.[14]

SWBT had high market shares in the major cities in its service territories. The FCC acknowledged that SWBT had market shares of 85% and 93% in two major market areas. As a result, the FCC concluded that SWBT had to offer a persuasive showing of competition to obtain pricing flexibility. In support of its petition, SWBT offered the following as evidence of competition in two markets, Dallas and Houston, asserting a loss of 43% in Dallas and 38% in Houston for high capacity services:

(1) requests for proposals ("RFPs") consisting of one to two pages letters from two customers with one-page attachments;

(2) customer anecdotes, set forth in footnote 16 of Description and Justification filed with Transmittal No. 2633 from a study commissioned by SWBT in 1993, in which SWBT customers state they would like to see SWBT be permitted to offer below-tariff rates;

(3) tariff pages from MFS and TCG purporting to demonstrate that these companies offer equal or lower-priced competitive alternatives;

(4) a quotation from a Time Warner promotional brochure describing Time Warner's SONET ring network in Indianapolis, and a quotation from an MFS brochure describing that company's facilities in unspecified locations, which SWBT contends demonstrate that the service described in the Time Warner and MFS

[14] *Id.* at 42.

tariff pages are comparable to the service that SWBT seeks to offer under this transmittal;

(5) a letter from AT&T acknowledging SWBT's response to AT&T's request and informing that AT&T had decided to "purchase other options"; and

(6) an assertion that SWBT has lost 43 percent of its share of the high capacity market in Dallas, and 38 percent in Houston.[15]

In rejecting the evidence offered by SWBT, the FCC wanted to see empirical evidence of substantial competition in all areas within SWBT and concluded "[t]he present record in this case, however, incorporates no persuasive showing that SWBT is experiencing substantial competition throughout its region. In short, the regulatory treatment of CAPs and SWBT is predicated on their markedly different economic circumstances and competitive opportunities."[16]

The FCC, in a decision released November 22, 1999, addressed various petitions filed by BOCs seeking forbearance from dominant carrier regulation for special access and high capacity dedicated transport services in certain markets. Their contentions were based upon a market share analysis that purported to show that the BOCs were no longer dominant carriers in various markets.[17] In its *Memorandum Opinion and Order*, the FCC rejected the claims raised by the BOCs that they were no longer dominant carriers after concluding that:

1. The information provided in support of the market study was insufficient,

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15 See *SWBT Order* at 46.

16 *Id.* at 52.

17 The FCC rejected the BOC's market share analysis and rejected their assertion that they were no longer dominant carriers. See *Petition Of U.S. West Communications, Inc. For Forbearance From Regulation As A Dominant Carrier in the Phoenix, Arizona MSA; Petition of SBC Companies For Forbearance From Regulation As A Dominant Carrier For High Capacity Dedicated Transport Services In Specified MSAs; Petition of U.S. West Communications, Inc. For Forbearance From Regulation As A Dominant Carrier in the Seattle, Washington MSA; Petition Of Bell Atlantic Telephone Companies For Forbearance From Regulation As Dominant Carriers in Delaware; Maryland; Massachusetts; New Hampshire; New Jersey; New York; Pennsylvania; Rhode Island; Washington, D.C.; Vermont; and Virginia; Petition Of Ameritech For Forbearance From Dominant Carrier Regulation Of Its Provision Of High Capacity Services In The Chicago LATA,* FCC 99-365, "*Memorandum Opinion and Order*," (rel. November 22, 1999).

2. The methodology chosen, DSI equivalency, was defective, and

3. Retail loss is an inadequate measure for loss in market share due to competition.[18]

Specifically, the FCC rejected claims by Bell Atlantic that its alleged loss of market share of 31.7 percent for special access services in 18 areas surveyed established it was no longer a dominant carrier.[19]

In rejecting the petitions, the FCC expressed concern over the effects of reduced regulation in the face of market power. Market power enables a BOC to overprice services where little competition is present to compensate for areas in which a company is facing competition. Specifically, the FCC opined in the *Memorandum Opinion and Order*:

> Absent a sufficient showing of competition, it's clear that the regulation of the BOC petition special access and high capacity transport services is necessary to protect consumers. Without such regulation and in the absence of competition, the BOC petitioners could discriminate against certain consumers by charging higher rates to those that lack competitive alternatives. For example, without our rate structure and rate level regulations, the BOC petitioners could engage in strategic pricing by offering reductions in rates for special access and high capacity dedicated transport services where they face competition, and higher rates for these services where they face little competition. This sort of strategic pricing discriminates among consumers not on the basis of cost characteristics but on the basis of availability of competitive alternatives. It deters entry by competitors. As we concluded in the pricing flexibility order, relaxation of our rate structure and rate level rules must be structured to prevent exclusionary pricing behavior so as to safeguard the development of competition. Similarly, because the BOC petitioners had failed to show that

18 *Memorandum Opinion and Order* at 14-19.

19 *Id.* at 13, footnote 74. In the *Memorandum Opinion and Order*, the FCC rejected the market share analysis offered by the BOCs. However, the FCC granted forbearance conditioned upon the BOCs complying with its recent Pricing Flexibility Order issued on August 27, 1999. The Pricing Flexibility Order established a procedure whereby price cap LECs, which include BOCs, can file petitions to obtain relief from certain Part 61 and Part 69 rules. The FCC reviews petitions in accordance with the bright line rules established in the Pricing Flexibility Order. These bright line rules avoid a showing of non-dominance but the FCC denied the petitioners' requests that the FCC determine that they are non-dominant carriers in specific markets (i.e., the BOCs retain market power).

> competition will constrain anti-competitive conduct by them, the public interest is best served by the continued regulation of special access and high capacity dedicated transport services which was designed to foster competition for these services. For these same reasons, we do not believe that forbearance from dominant carrier regulation will promote competitive conditions in the market for special access and high capacity dedicated transport services.[20]

In determining dominant or non-dominant status, the FCC reaffirmed its reliance on the framework outlined in the *Dominant/Non-Dominant Order.*[21] The FCC determines whether a carrier is dominant by: 1) delineating the relevant product and geographic markets for examination of market power, 2) identifying firms that are current or potential suppliers in that market, and 3) determining whether the carrier under evaluation possesses individual market power in that market.[22] Central to this inquiry is reliable market data concerning competitive market conditions for the service or services at issue.

In the *Dominant/Non-Dominant Order*, the FCC articulated the fact that BOCs and incumbent local exchange carriers ("ILECs") have monopoly power in the local exchange and access markets and that additional safeguards are required to ensure that such market power is not utilized.[23] For BOCs, the FCC concluded that Section 272(b) coupled with other requirements provides adequate assurances that abuses of market power can be identified and remedied.[24] For ILECs, the FCC concluded that the separate affiliate requirements established in

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20 *Id.* at 21.

21 *See Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, CC Docket No. 96-149, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, 12 FCC Rcd 15756, 15775, 15776, 15782 (1997) (*Dominant/Non-Dominant Order*).

22 *Id.*

23 See *Dominant/Non-Dominant Order* at 116 and 119.

24 *Id.* at 119.

the *Competitive Carrier Fifth Report and Order* along with other safeguards also provide adequate assurances that abuses of market power can be identified and remedied.[25] The FCC made it explicit that the public interest required that regulatory and statutory requirements such as separate affiliate requirements must be maintained as long as market power exists. The FCC acknowledged the Department of Justice's ("DOJ's") view that robust competition in the local exchange market is necessary to preclude adverse affects on consumers, competition and production efficiency.[26] Current statutory and regulatory safeguards imposed will prevent anticompetitive conduct.[27]

2. FCC Should Require BOCs to Demonstrate That No Subsidies Are Present in Local Exchange and Access Services, and That a BOCs Long Distance Affiliate is not Subsidized, by Using a Fully Distributed Cost Analysis.

A crucial component for ensuring that market power is not abused is the elimination of subsidies and the prevention and detention of misallocation of costs between various business segments. The Ratepayer Advocate submits that the cornerstone for elimination of subsidies and detection of misallocations is the FCC time tested fully distributed cost ("FDC") analysis. The FCC has consistently endorsed and approved the use of a fully distributed cost analysis to detect and prevent misallocation of costs.[28]

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25 *Id.* at 167 and discussions at 143-192.

26 *Id.* at 102.

27 *Id.* at 206.

28 For example, in the following four cases that span almost 25 years, an FDC analysis was used. See *I/M/O American Telephone and Telegraph Company, Long Lines Department Revisions of Tariff FCC No. 260 Private Line Services, Series 5000* (TELPAC) FCC 76-886, Memorandum Opinion and Order, Docket No. 18128, (October 1, 1976); *I/M/O Economic Implications and interrelationships Arising From Policies and Practices Relating to Customer Interconnection Jurisdictional Separations and Rate Structures*, FCC 80-5, Second Report (January 19, 1980); *I/M/O Economic Implications and interrelationships Arising From Policies and Practices Relating to Customer Interconnection Jurisdictional Separations and Rate Structures*, FCC 76-879, First Report (September 27,

On more than one occasion, the FCC has articulated why a FDC methodology is appropriate for assessing subsidies in services. The FCC expressed the value of an FDC-type analysis in identifying cross-subsidies:

> The relative characteristics and merits of FDC Method 1 and 7 were also outlined earlier (see Section XI). It was recognized that although not ideal, these two methods can provide a valuable guide for determining the justness and reasonableness of present and past return levels and relationships at issue herein. The results of analysis of return on investment in accordance with FDC Methods 1 and 7 provide a "zone of reasonableness" which enables us to evaluate the lawfulness of Bell's return levels. Although not necessarily perfect, these methodologies together are sufficient to identify cross-subsidization and provide carrier accountability.[29]

The FCC reiterated its findings from the *Memorandum and Order* concerning the advantages of a FDC analysis in detecting cross-subsidization.[30] Similarly, the FCC has

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1976); and *Implementation of the Pay Telephone Reclassifications and Compensation Provisions of the Telecommunications Act of 1996*, FCC 99-7, Third Report and Order on Reconsideration of the Second Report and Order, CC Docket No. 96-128, (February 4, 1999).

[29] *In the Matter of American Telephone & Telegraph Company, Long Lines Department Revisions of Tariff FCC No. 260 Private Line Services, Series 5000 (TELPAK), FCC 76-886, Memorandum Opinion and Order*, Docket No. 18128, at □ 184 (released, October 1, 1976).

[30] *In the Matter of Economic Implications and Interrelationships Arising From Policies and Practices Relating to Customer Interconnection, Jurisdictional Separations and Rate Structures*, FCC 80-5, *Second Report*, at 8 (released January 29,1980).

> Paragraph 41 and 335 of the First Report, 61 FCC 2d at 780 and 891, contain a discussion of Docket No. 18128, a proceeding instituted to establish certain general rulemaking principles and guidelines. We released our Docket No. 18128 Decision on October 1, 1976, 61 FCC 2d 587 (1976), wherein the Commission held that a revised fully distributed cost methodology (FDC) was the cost methodology more appropriate for determining rate levels of all services. It would enable the Commission to carry out its statutory responsibilities to ensure just, reasonable, and otherwise lawful rates and would permit the Commission to detect unlawful cross-subsidizations between and among services. (Docket No. 18128, 61 FCC 2d at 589, 610 and 641.) We note that FDC analysis assigns all recorded (actual) investment costs and operating expenses, measured over a given study period according to an allocative basis, e.g., causation or relative use, applied commensurately to all services. More particularly, the Commission rejected AT&T's proposed long-run incremental cost (LRIC) methodology, after concluding that it did not faithfully reflect valid marginal cost pricing theory, did not assure carrier accountability for rates, and

concluded that joint and common costs must be apportioned among all services as part of an appropriate subsidy analysis.[31]

Section 276 of the Act and the FCC's implementing regulations are very clear that all subsidies must be identified and removed.[32] The FCC concluded that the best way to assure the elimination of subsidies is by use of a fully distributed cost analysis. In the *Third Report and Order,*[33] the FCC recognized the difficulty in allocating common costs and opined that there is no one economically correct way to allocate such costs; and to avoid cross-subsidies, each service must recover at least its incremental costs and not more than its stand-alone costs. Within these parameters, different allocation procedures (or compensation amounts) could be considered fair. However, in the *Third Report and Order*, the FCC concluded that, "…a fully distributed cost-coverage approach best fulfills our statutory directives within the economic, technological, and statutory constraints that currently exist."[34] In view of the foregoing, the Ratepayer Advocate submits that the FCC should require a BOC to provide a fully distributed cost analysis for all local exchange and access services and for its long distance affiliate to demonstrate that no subsidies exist as one of the preconditions necessary before any Section 272(b) requirements are sunset.

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did not provide adequate safeguards against cross-subsidization of Bell's private line customers by its monopoly service customers (MTS and WATS).

31 *In the Matter of Economic Implications and Interrelationships Arising from Policies and Practices Relating to Customer Interconnection, Jurisdictional Separations and rate Structures,* FCC 76-879, First Report, at 132 (released September 27, 1976).

32 *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996,* FCC 99-7, *Third Report and Order on Reconsideration of the Second Report and Order*, CC Docket No. 96-128, at 23 (released February 4, 1999) (*Third Report and Order*)

33 *Id*. at 56.

34 *Id.* at 73.

3. Market Power Continues in Local Exchange and Access Services.

The FCC continues to find that incumbent LECs, including the BOCs, have market power in the provision of most services within their service areas. As recently as June 2000, the FCC reaffirmed its conclusion that BOC's are dominant carriers.[35] Chairman Powell recently expressed concerns over how slowly the markets have moved towards competition: "We correctly believed these markets didn't need to be natural monopolies and they could be competitive, but I think we tended to over-exaggerate how quickly and how dramatically it could become competitive."[36] It remains unclear how many CLECs will survive and be capable of offering competition to the BOCs.

The FCC also recently reiterated its position that continued regulation is necessary and proper until such time as the market is fully competitive. By way of example, the FCC still imposes regulation on the separations process despite the presence of competition.[37]

B. Direct and Indirect Costs of Continued Application of Section 272.

The Ratepayer Advocate submits that it is incumbent upon a BOC to demonstrate that the costs associated with the continuation of Section 272(b) requirements impose unreasonable burdens and costs on the provision of long distance service. Such burdens and costs must

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35 See *I/M/O Rulemaking to Amend Parts 1, 2, 21, and 25 of the Commission's Rules to Redesignate the 27.5-29.5 GHz Frequency Band, to Reallocate the 29.5-30.0 GHz Frequency Band, to Establish Rules and Policies for Local Multipoint Distribution Services and for Fixed Satellite Services*; CC Docket No. 92-297, *Third Report and Order and Memorandum Opinion and Order*, FCC 00-223, at □□ 4 and 10 (rel. June 27, 2000)(incumbent LECs hold a 93% national market share).

36 Yochi J. Dreazen, *FCC's Powell Says Telecom 'Crisis' May Allow a Bell to Buy WorldCom*, The Wall Street Journal, July 15, 2002, at A1.

37 In July 2000, the FCC imposed a jurisdictional freeze of Part 36 category relationships and jurisdictional allocation factors governing the separations process applicable to incumbent LECs but concluded that rate regulation is necessary until the market is fully competitive. See *I/M/O Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, *Recommended Decision*, FCC 00J2, at □ 7 (rel. July 21, 2000).

outweigh the benefits in assuring against the exercise of market power, protecting against improper cost allocation, and preventing unlawful discrimination and other anti-competitive practices, such as price squeezes.

At a minimum, the FCC should require a BOC to supply the following data and information with all supporting papers:

(1) That quantify with verifiable data what the direct and indirect costs are for maintaining a separate affiliated in accordance with Section 272(b) and demonstrate that the direct and indirect cost are substantial and material for maintaining a separate affiliate

(2) Provide the projected costs (direct and indirect) to convert from a separate affiliate to an integrated operation.

(3) Demonstrate that discontinuance of Section 272 requirements will result in cost savings that in turn will be passed on to consumers.

(4) Demonstrate that maintaining Section 272 will have a material and adverse affect on the rates of return of its long distance affiliate.

In addition, the Ratepayer Advocate asserts that the FCC should require a BOC to report the direct and indirect costs for initial compliance with Section 272(b) and exclude those initial direct and indirect costs incurred by the BOC to set up an affiliate from the analysis of the costs for the continued application of Section 272(b) requirements. In that regard, the FCC has already concluded that the separations requirements imposed on ILECs in the *Competitive Carrier Fifth Report and Order,* which have been in place for almost 15 years, are not overly burdensome.[38]

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[38] See *Dominant/Non-Dominant Order* at 165.

IV. Proposed Alternatives.

A. Comparative Analysis: The *Computer* Proceedings and Transition from Structural Separation to Non-Structural Safeguards.

The structural separation requirements of Section 272 are intended to prevent discrimination and cost misallocations by BOCs that provide in-region long-distance service prior to the development of full competition in the local exchange marketplace.[39] The intent of Congress when establishing these safeguards was to "prohibit anti-competitive discrimination and cost-shifting, while still giving consumers the benefits of competition."[40] Accordingly, the Ratepayer Advocate urges the retention of structural safeguards until such time as the BOC demonstrates affirmatively that it does not have market power.

In the instant NPRM, the FCC proposed several alternatives to structural separation. The Ratepayer Advocate submits that these proposals are not appropriate replacements for structural separation unless the BOC does not have market power. The FCC has previously replaced structural separation requirements with non-structural safeguards when changed market conditions have supported such a transition.[41] In *Computer I*,[42] *Computer II,*[43] and *Computer*

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[39] *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Telecommunications Act of 1934, as amended: First Report and Order and Further Notice of Proposed Rulemaking*, CC Docket No. 96-149, 11 FCC Rcd 21905 at ¶ 8 ("*Non-Accounting Safeguards Order*") (1996), *aff'd Bell Atlantic Telephone Companies v. FCC*, 131 F.3d 1044 (DC Cir. 1997).

[40] *Non-Accounting Safeguards Order* at ¶ 9.

[41] "Structural safeguards" in this discussion refers to mechanisms substantively similar to those described in Section 272(b)(3), specifically separate officers, directors, and employees. "Non-structural safeguards" refers to accounting, transactional, and performance safeguards.

[42] *Regulatory and Policy Problems Presented by the Interdependence of Computer and Communications Services and Facilities: Tentative Decision*, 28 FCC2d 291 (1970), *Final Decision* 28 FCC2d 267 (1970) ("*Computer I"*), *aff'd GTE Services Corp. v. FCC*, 474 F.2d 724 (2d Cir. 1973).

[43] *Amendment of Section 64.702 of the Commission's Rules and Regulations: Final Decision*, 77 FCC 2d 384 (1980) ("*Computer II"*), *modified on recon.* 84 FCC 2d 50 (1981) (*"Computer II Reconsideration Order*"), *modified on further reconsideration*, 88 FCC 2d 512 (1981) ("*Computer II Further Reconsideration Order*"), *aff'd sub nom.*,

III,[44] the FCC imposed, and then lifted, regulations that required AT&T (and, after divesture, BOCs) to offer "enhanced services" through separate affiliates. Similarly, the FCC may substitute structural separation of the BOC long distance affiliate with non-structural safeguards when specified conditions that cure concerns over misallocation of costs and cross subsidies are met.

In *Computer I*, the FCC sought to prevent cross-subsidization or other cross-over of costs and revenues between regulated telephone operations and data processing services.[45] Under *Computer I*, telephone companies were permitted to provide data processing services only through structurally separate affiliates which would have separate books, officers, personnel, and facilities; carriers with less than $1,000,000 in operating revenues were exempt from the requirements.[46]

Computer and Communications Industry Association v. FCC, 693 F.2d 198 (DC Cir. 1982), *cert. denied* 461 US 938 (1983), *aff'd on second further recon.*, FCC 84-190 (May 4, 1984).

44 *Amendment of Sections 64.702 of the Commission Rules and Regulations: Report and Order - Phase I*, CC Docket No. 85-229, 104 FCC 2d 958 ("*Phase I Order*"), *recon.* 2 FCC Rcd 1135 (1987) ("*Phase I Reconsideration Order*"), *further recon.* 3 FCC Rcd 1135 (1988) ("*Phase I Further Reconsideration Order*"), *second further recon.* 4 FCC Rcd 5927 (1989) ("*Second Further Reconsideration Order*") *Phase I Order* and *Phase I Reconsideration Order vacated sub nom.*, *California v. FCC*, 905 F.2d 1217 (9th Cir. 1990) ("*California*"); Phase II, CC Docket No. 85-229, 2 FCC Rcd 3072 (1987) ("*Phase II Order*"), *recon.*, 3 FCC Rcd 1150 (1988) ("*Phase II Reconsideration Order*"), *further recon.* 4 FCC Rcd 5927 (1989) ("*Phase II Further Reconsideration Order*"), *Phase II Order vacated sub nom.*, *California v. FCC*, 905 F.2d 1217 (9th Cir. 1990); *Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards*, 6 FCC Rcd 7571 (1991) ("*BOC Safeguards Order*"), *recon. dismissed in part*, Order, CC Docket Nos. 90623, 92-256, 11 FCC Rcd 12513 (1996), *BOC Safeguards Order vacated in part and remanded, California v. FCC*, 39 F.3d 919 (9th Cir. 1994) ("*California III*"), *cert. denied*, 115 S.Ct. 1427 (1997) (hereinafter collectively referred to as "*Computer III*").

45 *Computer 1* at ¶ 10.

46 It is instructive to recall that *Computer I* was issued before the divesture imposed under *United States v. Western Electric Co.*, 552 F.Supp. 131 (Dist. DC 1982) (subsequent history omitted) ("*MFJ*"). Although the *MFJ* prohibited the BOCs from providing information services, that restriction was lifted in *United States v. Western Electric Co.*, 714 F. Supp. 1 (Dist. DC 1988), *United States v. Western Electric Co.*, 767 F.Supp. 308 (Dist. DC 1991) (subsequent history omitted). After 1991, BOCs were still prohibited from providing information services across LATA boundaries, but Section 152 of the Act eliminated that restriction as well.

In *Computer II*, the FCC "redefined" the telephone system to include only basic services and all other services, now known as "enhanced services," were required to be offered only by an affiliate. This move came as a result of the increasing implementation of computers into telecommunications equipment.[47] The FCC defined "enhanced services" as including voice-mail, e-mail, and interactive voice response.[48]

Computer III replaced the structural separation requirements of *Computer II* with non-structural safeguards. As described more fully below, these non-structural safeguards included FCC approval of BOC offerings in order to ensure that vital network elements were available to competitors, and the implementation of open network architecture ("ONA"). This created a presumption of an open and accessible backbone network. On judicial review, the Ninth Circuit ruled that the FCC could permit accounting safeguards to take the place of structural separations, but that the FCC's decision to do so had not been justified adequately.[49] In January 1998, after eight years of judicial remands and agency proceedings, the FCC released a Further Notice of Proposed Rulemaking seeking industry comments on the interplay between the *Computer III* regulations and the Act.[50] Although no decision on the pending 1998 FCC inquiry has been issued,[51] the FCC's statement of the reasons underlying its *Computer* policies is instructive when

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[47] *Computer II* applied in practice only to AT&T, the only telephone company large enough, in the eyes of the Commission, to engage in meaningful anti-competitive conduct that would affect the fledgling computer/telecom industry. Under *Computer II*, AT&T's local affiliates could offer only basic telephone service, while enhanced services were to be offered by separate affiliates. These regulations were extended to the BOCs after the break-up of AT&T. *See United States v. AT&T*, 552 F.Supp. 131, 229 (Dist. DC 1982).

[48] *See Bell Operating Companies Joint Petition for Waiver of Computer II Rules: Order*, 10 FCC Rcd 13,758, 13,770-774 (1995).

[49] *California*, note 6, *supra.*

[50] *Computer III Further Remand and FNPRM*, note 3, *supra*.

[51] In March 2001, the Commission again sought comments intended to "refresh" the record. *See* "Further Comment Requested to Update and Refresh Record on Computer III Requirements," CC Docket Nos. 95-20, 98-10,

formulating safeguards for a post-272 environment. Indeed, Section 276 of the Act incorporates specifically non-structural safeguards of *Computer III* as appropriate non-structural safeguards for BOCs.[52]

The FCC was wary of the BOCs using their local exchange market power to discriminate against other enhanced services providers. *Computer I* and *Computer II* imposed structural safeguard requirements; *Computer III* replaced those mechanisms with accounting and other non-structural safeguards only when other safeguards were in place. The phased reduction of safeguards was linked directly to BOC fulfillment of pro-competitive measures.[53] Accordingly, the Ratepayer Advocate proposes enforcement mechanisms and other safeguards that can be employed in order to ensure that a BOC that is relieved of structural separation requirements continues to operate in a non-discriminatory manner.

B. Fortify Existing Nonstructural Safeguards and Implement an Annual Audit.

The Ratepayer Advocate recommends a plan that blends several aspects of the alternatives proposed in the FCC's Section 272 NPRM.[54] Under the Ratepayer Advocate's plan, sunset of the separate affiliate requirement would take effect only after the BOC has provided sufficient evidence to the FCC demonstrating that it no longer possesses market power in a

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Public Notice, DA 01-620 (Mar.7, 2001). As of the filing of these Comments, no decision on the matter has been issued.

52 47 U.S.C. § 276(b)(C).

53 *See Computer III Further Remand and FNPRM* at paras. 10, 11.

54 *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-112, Notice of Proposed Rulemaking, (rel. May 24, 2002) ("Section 272 NPRM"). The Commission's alternatives which are the basis of the Ratepayer Advocate's plan include: (1) extension of the statutory requirements by rule for a defined period of time; (2) sunset requirements but adopt less stringent separation requirements; and (3) allow separate affiliate to sunset after three years, but retain non-discrimination requirements and/or biennial audit. *Id*. at ¶¶ 21-25.

particular state.[55] The Ratepayer Advocate's plan also contemplates that once the separate affiliate requirement is lifted, the BOC must be subject to strong nondiscriminatory safeguards and an annual audit in order to prevent backsliding behavior.

In the event the FCC determines that a BOC has sufficiently proven that it should no longer be subject to the separate affiliate requirement of Section 272, the continued application of Section 272(e)(1) and Section 272(e)(3) is essential to assure nondiscriminatory behavior by the BOC. As the FCC explained in their Non-Accounting Safeguards NPRM,[56] a BOC could potentially discriminate against a competitor by offering inferior services, by charging higher prices, by withholding cooperation to a competitor's effort to introduce a new service, or by sharing information with an affiliate with respect to network changes, but not with the competitor.[57] Moreover, in the absence of a separate affiliate requirement, the nondiscriminatory requirements of Section 272(e)(1) and Section 272(e)(3) become paramount and must be sufficient to prevent preferential treatment for the BOC and BOC affiliates to the detriment of CLECs.

1. Compliance with Section 272(e)(1).

Section 272(e)(1) provides that BOCs and their incumbent LEC affiliates "shall fulfill any requests from an unaffiliated entity for telephone exchange service and exchange access within a period no longer than the period in which it provides such telephone exchange service to

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[55] *See infra* Section II for a more detailed discussion of the factors to be considered by the Commission in deciding whether to eliminate the separate affiliate requirement for BOCs.

[56] *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934*, as amended, CC Docket No. 96-149, FCC 96-308, released July 18, 1996 ("Non-Accounting Safeguards NPRM").

[57] Non-Accounting Safeguards NPRM at ¶ 65.

itself or to its affiliates."[58] This provision basically prohibits any conduct in fulfilling service requests that favor a BOC, or BOC affiliate, regardless of the line of business in which either participates.[59] This rule reflects the reality that the timely fulfillment of requests for exchange service and access – including the development of new services – is a vital requirement in the development of a competitive environment.

The Ratepayer Advocate submits that Section 272(e)(1) is best enforced through quarterly reporting requirements under which the BOC reports time intervals for fulfilling initial installation requests as well as subsequent requests for improvement, upgrades or modifications of service or repair and maintenance of these services, for both competitors and affiliates.[60] In related proceedings, the FCC has recognized that performance standards and reporting requirements are useful tools in determining whether BOCs are in compliance with their statutory obligations.[61] The FCC also found that performance requirements would be effective in implementing section 272(e)(1), stating that, "BOCs must make publicly available the intervals within which they provide service to their affiliates…[and] without this requirement, competitors will not have the information they require to evaluate whether the BOCs are fulfilling their

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58 47 U.S.C. § 272(e)(1).

59 *See* Non-Accounting Safeguard NPRM at ¶¶ 81-82.

60 The recommended reporting requirements are similar to those implemented by the Commission in *Filing and Review of Open Network Architecture Plans*, Memorandum Opinion and Order on Reconsideration, 5 FCC Rcd 3084, 3093-94, 3096 (Appendix B) (1990). Consistent with the Commission's holding in that decision, BOCs should not report on average intervals for installation and maintenance activities, but should provide on a quarterly basis reports on requests by both affiliates and competitors and responses by the parent.

61 *Performance Measurements and Standards for Interstate Special Access Services et al*, CC Docket No. 01-321,Notice of Proposed Rulemaking at ¶ 13, FCC 01-339 (rel. Nov. 19, 2001) ("Special Access Measurements and Standards Notice").

requests for telephone exchange service and exchange access in compliance with Section 272(e)(1)."[62]

In complying with Section 272(e)(1), the BOC must provide data in the quarterly report detailing the length of time taken to provision telephone exchange service and exchange access to itself and its affiliates compared to the time taken to provision the same services to non-affiliates. Response times should be categorized by each type of service requested, including separate categories for initial requests, subsequent requests, upgrades, maintenance, etc.[63] Most importantly, the FCC must establish benchmark performance standards for each service category, and require the BOC's performance to meet the benchmark standard in order to prove that they are providing nondiscriminatory service to non-affiliates.[64] The Ratepayer Advocate recommends that the FCC refer to the format for service categories and units of measure set forth in Appendix C of the *Non-Accounting Safeguards Order*[65] as a starting point in formulating service categories and benchmark standards for purposes of measuring the BOC's service quality performance in fulfilling requests from unaffiliated carriers.

The FCC must also require BOCs to offer affiliated and unaffiliated carriers the same, or equally efficient, procedures for requesting service, and routinely notify non-affiliates of any

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62 *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934*, as amended, CC Docket N0. 96-149, FCC 96-489, First Report and Order and Further Notice of Proposed Rulemaking at ¶ 368, released Dec. 24, 1996 ("Non-Accounting Safeguards Order and Further Notice").

63 Underlying data for each request or individual transaction should also be provided; average or aggregated data should not be deemed to comply with this disclosure requirement.

64 *Performance Measurements and Standards for Unbundled Network Elements and Interconnection*, CC Docket 01-318, Notice of Proposed Rulemaking at ¶ 32, FCC 01-331, (rel. Nov. 19, 2001) ("UNE Performance Measurements NPRM") (recognizing that proper benchmark standards for each measurement is important to any performance plan).

65 *See Non-Accounting Safeguard Order*, Appendix C.

improvements and upgrades in those procedures.[66] For example, a BOC that enabled its affiliate to place service orders electronically while requiring unaffiliated carriers to order by conventional voice, fax, or other slower less reliable means, could achieve a significant competitive advantage while reporting similar response times. Thus, the BOC must be required to expend the same degree of effort in understanding requests and correcting errors in requests made by non-affiliates as it does in responding to requests by personnel of the BOC or the BOC's customers or affiliates.[67]

The Ratepayer Advocate submits that these reporting requirements will reveal vital information about the quality of the services BOCs provide to their Section 272 affiliates, and will better enable outside parties, and more importantly, this FCC and state commissions, to detect improper discrimination by a BOC in favor of its affiliate, in violation of Section 272(e)(1).[68]

a) Self-Executing Remedies and Penalties Will Further Prevent Discrimination.

Given the BOC's incentives to discriminate against competitors, the Ratepayer Advocate recommends that the FCC establish self-executing remedies and penalties for failure to meet the established performance standards pursuant to Section 272(e)(1). Indeed, there is a significant need for FCC enforcement action when a BOC is found to be provisioning requests by unaffiliated entities in an untimely manner as compared to affiliated entities. Without remedies

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66 Comments of AT&T Corp, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934*, as amended, CC Docket No. 96-149 at 38 (Aug. 15, 1996) ("AT&T Comments").

67 *Id.*

68 *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, CC Docket No. 96-149, Third Order on Reconsideration at ¶ 32, FCC 92-242, (rel. Oct. 1, 1999) (citing MCI Comments at 10-13).

that provide incentives to correct these types of deficiencies, performance standards become futile. Therefore, the BOC should be subject to penalties for failure to comply with the quarterly reporting requirements of Section 272(e)(1).

The penalties should be designed to ensure that a BOC would rather avoid the penalty than enjoy the benefit to be gained by handicapping its competitors. The triggers for the penalties and the amount of the penalties could be modeled after a solid state Performance Assurance Plan ("PAP") design such as the plan recently adopted in New Jersey.[69] Furthermore, remedies should apply across the board to all unaffiliated carriers where it has been shown that the BOC failed to meet the relevant performance standard for carriers as a whole.[70] However, in cases where the BOC provides particularly poor service to a specific unaffiliated carrier, the remedy should be higher for that carrier than for other carriers.[71] Moreover, in the case of both the across the board carrier remedies and the carrier-specific remedies, repeated failures to meet performance standards should result in a higher amount of remedies.[72]

Such financial penalties should increase the cost of discrimination, but they may not be sufficient by themselves to deter BOC anti-competitive behavior completely. The FCC must therefore establish a presumption that, if a BOC repeatedly fails to meet a performance standard, the FCC will issue a notice of apparent liability and seek to impose penalties pursuant to Section

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69 *See* New Jersey Board of Public Utilities, *Investigation Regarding Local Exchange Competition for Telecommunications Services et al*, Docket Nos. TX95120631, TX98010010, Order Approving Incentive Plan, Appendix B, (Jan.10, 2002) ("NJ Incentive Plan").

70 *Id.*

71 *Id.*

72 *Id.*

503 of the Act.[73] The level of the penalty should be adjusted to correspond with the degree to which the BOC has missed the relevant standard and the degree to which the BOC has missed performance standards in the past.[74]

2. Compliance with Section 272(e)(3).

Section 272(e)(3) requires that BOCs and their LEC affiliates charge their interLATA affiliates, or impute to themselves an amount for access to telephone exchange service and exchange access "that is no less than the amount charged to any unaffiliated interexchange carrier for such service."[75] Currently, compliance with Section 272(e)(3) is achieved through the BOC providing access under tariffed rates, in which they charge their affiliates or impute to themselves the tariffed rate.[76] However, once the separate affiliate provision is eliminated, tariffed rates will no longer be sufficient to assure that the BOC or BOC affiliate formally incurs a charge that is "no less than" the amount charged to an unaffiliated interexchange carrier.

Thus, the Ratepayer Advocate recommends that BOCs be required to submit quarterly reports detailing the following: (1) all charges made directly or imputed to itself for providing an affiliate with telephone exchange service and access to the network[77]; and (2) the rates, terms, and conditions under which it made available to its affiliate any interLATA or intraLATA

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73 Section 503 of the Act states that any person who "willfully or repeatedly failed to comply with any of the provisions of this ACT or of any rule, regulation, or order issued by the Commission under this Act . . . shall be liable… for a forfeiture penalty." *See* 47 U.S.C. § 503(b)(1)(B).

74 NJ Incentive Plan at 21.

75 47 U.S.C. § 272(e)(3).

76 *See* Non-Accounting Safeguard Order and Further Notices at ¶ 256.

77 This aspect of the quarterly report would include all prices charged by the BOC to its affiliate, by the affiliate to the BOC, or by third party vendor to either the parent or the affiliate. This information will substantially assist in the detection of cost misallocation between BOCs and their affiliates.

facilities or services.[78] This information will facilitate the FCC in the detection of cost misallocation between the BOCs and their affiliates, the risk of which is greater once the BOC is no longer required to establish a separate long distance affiliate.

3. An Annual Audit is Necessary to Monitor Compliance with Section 272(e)(1) and Section 272(e)(3).

The Ratepayer Advocate submits that the risks to competition associated with cost misallocation and discrimination are sufficiently great to warrant imposition of reporting requirements. Once sunset of the separate affiliate occurs, nondiscrimination safeguards must be reinforced to prevent BOCs from acting to the detriment of competitors or reacquiring market power. If a BOC fails to report the proper data or fails to report it accurately, the entire performance regime will be undermined. Therefore, the Ratepayer Advocate recommends that the FCC conduct a comprehensive annual audit of the quarterly reporting requirements of Section 272(e)(1) and Section 272(e)(3).[79] The audit would include a comprehensive review of the BOC's procedures for complying with the reporting guidelines, in addition to reviewing the data reported by the BOC for accuracy. Thus, to the extent that an audit demonstrates that a BOC submitted false or inaccurate data, BOCs must be subject to significant penalties. More importantly, if an audit or FCC investigation reveals that a BOC intentionally submitted false data, the FCC should levy even more severe penalties. Furthermore, the Ratepayer Advocate submits that an unaffiliated carrier should be allowed to petition the FCC to conduct a special

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78 See Comments of Teleport Communications Group Inc, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934*, as amended, CC Docket No. 96-149 at 16 (Aug. 15, 1996) ("Teleport Comments").

79 *See infra* Section IV for additional discussion on the inadequacy of the biennial audit, which necessitates an annual audit.

audit of data where the carrier can make a *prima facie* case that the data for a particular state is unreliable.[80]

[80] Comments of Association of Local Telecommunications Services, *Performance Measurements and Standards for Interstate Special Access Services et al*, CC Docket No, 01-321 at 12, (Jan. 22, 2002).

V. Enforcement Tools Available After Sunset.

A. Biennial Audit.

The FCC asks whether Section 271(d) would be sufficient to address potential discrimination or cost misallocation.[81] The Ratepayer Advocate submits that the biennial audit does not provide sufficient protection or discouragement against anti-competitive conduct. In the first instance, the audit is too infrequent. The FCC itself notes in the instant NPRM that a BOC's second biennial audit would not be available until after the three-year period has passed.[82] To contrast, common carriers and certain affiliates must annually file reports attesting to their accounting and cost allocation methods.[83] Further, although the biennial audit can provide a valuable review of corporate activity, it provides historic perspective only, and does not provide sufficient deterrent value when set against the interests of Section 272. Recent events among large American companies have highlighted the fact that manipulated or inaccurate audits can remain undetected for years before massive consequences are suffered. Accordingly, the Ratepayer Advocate warns against reliance on biennial audits alone.

Section 272 provides that the biennial audit applies only where structurally separate affiliates exist. Accordingly, the Ratepayer Advocate submits that the FCC should clarify that currently effective annual audit requirements imposed on common carriers and certain affiliates will apply to BOCs that are relieved of the biennial audit requirement. Additionally, if the separate affiliate requirement is eliminated, then the Ratepayer Advocate recommends adoption

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81 NPRM at ¶ 24.

82 NPRM at ¶ 19.

83 47 C.F.R. § 43.21.

of accounting safeguards similar in substance, if not form, to those adopted in the *Computer III* remand proceedings.[84] These include:

(1) Verifiable treatment of all local and long-distance for accounting purposes.

(2) Same level of assurance of independent auditors as provided in a financial statement audit engagement.

(3) Industry-wide uniform reporting methodologies, similar to cost account manual preparation.

(4) Establishment of a threshold for determining the materiality of errors and omissions discovered in the independent audits of carrier findings.

Additionally, the Ratepayer Advocate also recommends that BOCs that are relieved of structural separation requirements be subjected to those requirements of Section 64.1903 applicable to non-dominant affiliate providers of interstate, interexchange services, specifically: (a) to maintain separate books of account, (b) to not jointly own transmission or switching facilities with its affiliated exchange telephone company, and (c) to acquire any services from its affiliated exchange telephone company at tariffed rates, terms, and conditions.[85]

B. Modification or Removal of Safeguards.

The FCC also asks whether it should permit a mechanism for removing or modifying safeguards if less intrusive safeguards are adopted in lieu of structural separation requirements.[86] The Ratepayer Advocate submits that the FCC should offer this incentive to the marketplace. The ultimate goal of removing all artificial regulatory barriers should be at the horizon; the FCC has taken this approach in previous proceedings.

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84 *See BOC Safeguards Order* at paras. 14-41, note 6, *supra.*

85 *See Policy and Rules Concerning Rates for Competitive Carrier Services and Facilities Authorizations Therefor: Fifth Report and Order*, CC Docket No. 79-252, 98 FCC2d 1191, ¶ 9 (1984).

86 NPRM at ¶ 28.

The non-structural safeguards of *Computer III* required the BOCs to obtain approval of comparably efficient interconnection ("CEI") plans before offering a new enhanced service. This was intended to assure that competitive enhanced service providers would be able to avail themselves of the underlying services on a non-discriminatory basis. In short, the BOCs were permitted to enter the enhanced services market, so long as they shared their networks and made them fully accessible to their competitors. *Computer III* also introduced open network architecture ("ONA"), which would relieve the BOCs of securing CEI approval. ONA was intended to permit competitive providers access to key components of basic local telephone service, and implementation of ONA created the presumption of an open network. As such, before the implementation of an open network architecture, the BOCs were relieved of structural separation if individual CEI plans were approved, but once ONA was implemented, a presumption of openness existed and a separate case-by-case approval process was no longer necessary.

C. Revisiting Safeguards.

The FCC also asks whether it should revisit safeguards after a specified time to determine their necessity.[87] In response, the Ratepayer Advocate notes the goal of the Act, which is to "accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans opening all telecommunications markets to competition."[88] This is not a goal that can be achieved with a solitary action, but rather requires a process of steps and measures. Accordingly, the revisiting of safeguards or other regulations as

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87 NPRM at ¶ 28.

88 Joint Statement of Managers, S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. Preamble (1996).

the market changes is wholly consistent with the nature of the development of a competitive marketplace. Indeed, the Act itself recognizes the changing nature of the marketplace, mandating, *inter alia*, biennial review of regulations[89] and, recognizing technological changes, ongoing review of services that are eligible for universal service.[90]

The Ratepayer Advocate submits that Sections 271 and 272 serve less the goal of introducing new services to the marketplace than they do the twin goals of (a) encouraging the BOCs to open their networks and markets to competition, and (b) the prevention of cross-subsidization and other unfair practices. The goal of Section 271 is to foster the introduction of competitive local exchange service, rather than to enhance the interLATA long-distance marketplace. Since the enactment of the Act and the subsequent grant of Section 271 applications, however, there has been no evidence that BOCs (or other LECs) have greatly diminished control over bottleneck facilities or lost market power.

Sections 251, 252, and 271 are all intended to open the local exchange market to substantial competition. Accordingly, safeguard requirements as set forth in Section 272 should not be removed until substantial competition exists. The presumption of the Act is that grant of Section 271 authority would either evidence or lead to conditions that would justify the removal of separate affiliate requirements; the statute states that the separate affiliate requirements "*shall* cease to apply…unless the Commission extends."[91] Those marketplace conditions, however, have not yet arrived. Safeguards should neither be relaxed nor removed so long as a BOC retains market power.

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[89] 47 U.S.C. § 402.

[90] *See* 47 U.S.C. § 254(c)(1).

[91] 47 U.S.C. § 271(f)(1) (emphasis added).

Accordingly, BOCs should be granted relief from the safeguards only upon specific showing that the basis upon which those safeguards were imposed no longer exists. The Ratepayer Advocate submits that the FCC should impose a process whereby the requirements are continued indefinitely until lack of market power is shown affirmatively. The FCC could also establish criteria that would permit a BOC to petition for relief from the requirements. The practice of revisiting is evident in the *Computer* proceedings, where the FCC revised its rules on the basis of market conditions. In any event, the removal of any safeguards would be executed on a state-by-state basis after examination of the relevant marketplace.

VI. Conclusion.

As Section 271 authority to provide interstate long distance service is awarded on a case-by-case basis based on established measures that justify the grant of authority, so too should the lifting of Section 272 requirements that are designed to assure that the BOCs do not exercise their acknowledged market power to the detriment of the Act's fundamental thesis – fair competition. Examination of a BOC application for sunset is appropriate, with the BOC bearing the burden of proof to affirmatively show that local markets are fully competitive.

If a particular BOC satisfies the multi-factor market analysis proposed herein, then the inquiry turns to what non-structural safeguard requirements are needed to assure against any backsliding once sunset occurs. The Ratepayer Advocate submits that non-structural safeguards and the application of Section 64.1903 are necessary to accomplish the goals and objectives of the Act, especially in an ever-shrinking telecommunications market. While the Act fostered competition, and in turn the prospects of competition fueled economic growth, investment and development, the prospect of a return to monopolistic control can overpower economic investment, development and enthusiasm.

Therefore, it is imperative that the sunset provisions of Section 272 not be applied automatically. The applicant's market power must be tested to determine that it no longer has the level of control it had at the time Section 271 authority was granted, that the BOC does not engage in anti-competitive conduct, and that the local exchange market is fully competitive. Yet, once sunset is found to be appropriate, measures that provide assurances against backsliding must be in place.

Respectfully submitted,
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